

This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 ANKARA 004530

SIPDIS

DEPT FOR EB/OMA AND EUR/SE
TREASURY FOR CPLANTIER

SENSITIVE BUT UNCLASSIFIED

E.O. 12958: N/A

TAGS: [EFIN](#) [TU](#) [IMF](#)

SUBJECT: IMF RESREP SEES COMPRESSED FALL CALENDAR, INCREASED
CURRENT ACCOUNT CONCERNS

1.(SBU) Summary: In a tour d'horizon with the Charge, the IMF Resrep pointed out that the delay in passing Social Security legislation has further compressed an already-packed calendar of required actions from September through November, just as the GOT is beginning EU accession negotiations. He also said the Fund's view of the current account deficit has shifted--they no longer expect it to self-correct any time soon. Unfortunately, there are no good policy tools available. Lamenting the GOT's serial proposals for tax exemptions and amnesties, he wished senior GOT politicians would put more effort into tax compliance. End Summary.

Compressed Fall Calendar:

2.(SBU) In a wide-ranging first meeting with the Charge d'Affaires, the IMF Resrep noted that the GOT's failure to pass the Social Security legislation in late June means that this legislation will be added to a series of actions the GOT is required to take between September and November, just as it is beginning accession negotiations with the EU. The Resrep believed the GOT sincerely made an effort to push through the legislation, but miscalculated how much time it would take, underestimating the ferocity of the opposition's delaying tactics.

3.(SBU) Now, however, the GOT faces an extraordinary amount of work in the fall. Early in September an IMF mission plans to come to begin work on the Second Review. During September (assuming parliament is called back earlier than its beginning-of-October start date), the GOT will need to pass not only the Social Security law, but also the law merging the three Social Security Institutions. It will also need to pass a law allowing the state to pay the health insurance premia for low-income citizens. Also in the fall, the GOT is supposed to pass a law reforming personal income taxes--a reform on which the GOT has yet to make any proposals to Fund staff. The GOT also needs to develop, with IMF technical assistance, a comprehensive strategy on Social Security arrears. This, too, will require legislation. Finally, the GOT will need to override President Sezer's veto of three articles of the Banking Law, and the GOT and the BRSA (Bank Regulatory and Supervisory Agency) will need to work with the IMF on implementing regulations for the Banking Law.

Front-Loaded Structural Reform in the Program:

4.(SBU) Whenever GOT officials are asked how Minister Babacan will be able to handle both his macro/IMF responsibilities and his new EU negotiator job, their standard line is that the structural reform under the IMF program is front-loaded. The theory being that once Babacan wraps up the first year of the program with its heavy structural reform agenda, he will be freer to work on EU matters. Babacan himself repeated this line to the Charge in a July 28 meeting (septel).

5.(SBU) As the list of actions described above suggests, they are right to say the structural conditionality is front-loaded, and the Resrep confirmed this. He went on to explain, however, that the Fund deliberately put most of the structural conditionality into the first year of the program, knowing full well based on past experience that the GOT will be slow to implement them, and the timing of the actions will slip.

6.(SBU) The Resrep described the current period as one of transition, with a shift in the program from an emphasis on the macro targets to more difficult structural conditionality. Whereas there is a broad consensus in the GOT in support of the macro policies, including the fiscal austerity, there is far less of a consensus around the structural reforms.

Social Security Follies:

17. (SBU) The Resrep explained why Turkey's current unreformed social security system was so badly in need of reform. The system combined extraordinary generosity with weak enforcement of premia payments. Aside from allowing people to retire after only twenty years, i.e. in their forties, pension payments are not taxable, allowing retirees in some cases to earn a higher after-tax income than when they were working.

Structural Barriers to Employment:

18. (SBU) Employers' social security payments are an important component of Turkey's relatively high "tax wedge," i.e. payroll taxes. He said while the level is comparable to some central European countries it is high compared to other OECD countries or Emerging Market countries. Another deterrent to hiring is Turkey's high cost of severance: one month per year worked with no cap. He said the Fund is encouraging the GOT to look at these kind of structural barriers to employment, including the absence of employment agencies.

If Only they Focused on Tax Compliance:

19. (SBU) As he has before with econoff, the Resrep lamented the 'Turkish political class' obsession with exemptions and amnesties. If only they could make a priority of enforcement of tax and social security premia payments, they would give more credibility to their tax system, yield large increases in collections and thereby be in a position to begin cutting rates or spending more on budgetary priorities.

IMF Shifts on Current Account Concern:

10.(SBU) Whereas over the past two years, Fund officials have tended to downplay the risks associated with Turkey's large current account deficit, for the first time the Resrep admitted there had been a shift in Fund thinking towards greater concern. Mirroring independent analysts' concerns, the Resrep said unlike last year, there is less and less likelihood of the current account deficit self-correcting. Note: Though he did not say why, many economists point to the role of high oil prices keeping the trade deficit wide, and the continued flood of portfolio investment preventing an adjustment in the exchange rate which would moderate import growth and keep exports competitive. End Note. On the other hand, the Resrep said there are no good policy options to deal with the problem. The Central Bank cannot tighten monetary policy and with the primary surplus target of 6.5% of GDP already one of the highest in the world, the GOT can hardly tighten fiscal policy. The Resrep did note one bright spot relating to the financing of the current account deficit: the apparent pick-up in FDI, in particular from privatization transactions.

McEldowney